IN THE

# Supreme Court of The United States

OCTOBER TERM, 1978

No. 77-1820

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AND TEXAS EASTERN TRANSMISSION CORPORATION,
*Petitioners,*

v.

FEDERAL ENERGY REGULATORY COMMISSION,
*Respondent.*

## PETITIONERS' REPLY TO MEMORANDUM IN OPPOSITION

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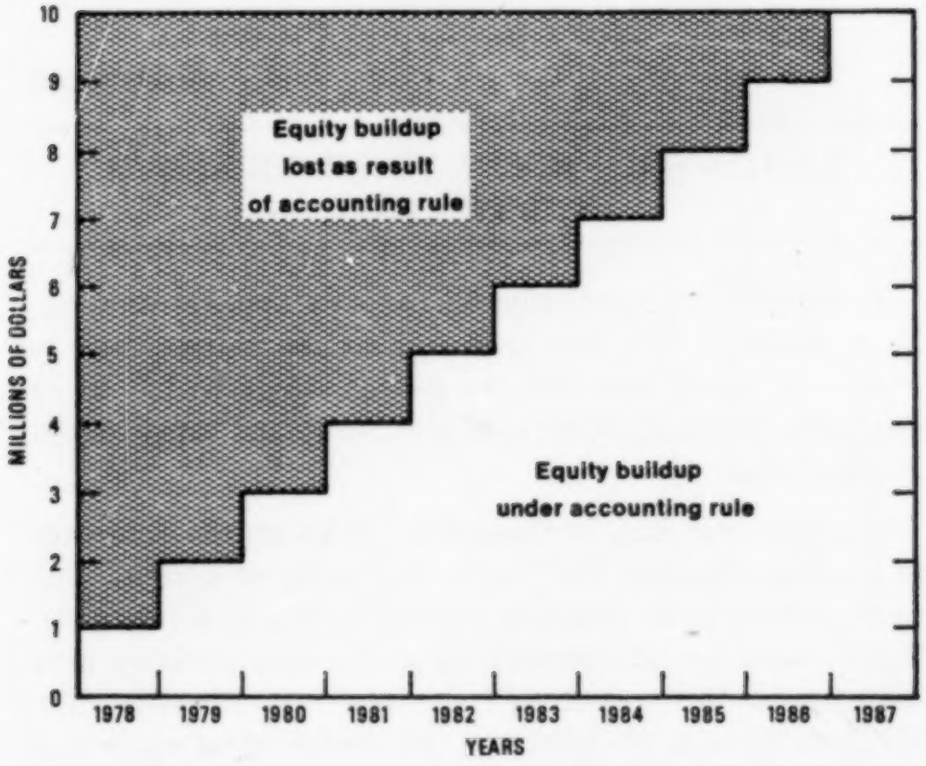
Petitioners recognize that this matter appears complex. It is precisely this fact that enables the Commission to create the impression that the matter should be left to its expertise, that it has not acted arbitrarily and capriciously. In fact, it has.

The Memorandum in Opposition picks up the reference in Opinion 505-B to the "[u]se of a uniform system" and to the matching of costs and revenues (Memorandum p. 2). These comments are diversionary. There is no issue here with respect to the desirability, indeed, the necessity, of a Uniform System of Accounts. No matching of costs and revenues is involved. The Commission knows well that these are "below the line" items. They are not matched in the ratemaking process. There is no question here

involving rates or ratemaking (see App. 103). As the New York Public Service Commission explained in its comments, the rule is neither involved in nor necessary to the "test year" concept in rate regulation (App. 132).

It may be that the Commission does not realize what it has done. After purporting to set out the consequences of the rule in footnote 2, page 4 of the Memorandum in Opposition, the statement is made "[o]ver a number of years it is difficult to see what difference the rule would make to petitioners' ability to sell debt securities".

Petitioners have apparently been unable to make the Commission see the difference the rule would make. Perhaps an illustration would help.




Debt indenture limitations customarily limit the amount of debt a utility is permitted to issue to three times equity.



The above illustration assumes a $10 million gain as a result of 1978 transactions required to be amortized over ten years. If the $10 million gain is reflected currently, the full $10 million would be included in the equity account and would remain there throughout the entire ten year period. If amortization is required, only $1 million of the $10 million is taken into equity in the first year. An additional $1 million is added during each succeeding year. It is this deferral that causes a permanent, irretrievable loss of borrowing capability. The equity buildup during subsequent years does not offset the reduced borrowing capability during the earlier years. The latter years' equity would be there in either event.

Under standard indenture limitations, the utilities' lost borrowing capability for any particular year would be *three times* the amount of the lost equity buildup for that year. Consequently, any financing during such "lost equity buildup" period, assuming the applicability of the indenture limitation, would have to be through more expensive equity offerings. This is one of the differences the rule makes. As stated in the Petition, it also makes capital attraction more difficult through artificially reduced earnings and interest coverages.

It is not enough for the Commission to say that the rule will "assist" it. As the Court of Appeals held in its first opinion, when the Commission promulgates a rule which changes an accounting practice in effect for many years and which deviates from generally accepted accounting principles, the Commission must explain *how* the new rule will assist it (App. 106). It has never done so. In fact, it cannot do so.

The rule is arbitrary and capricious. The Court is urged to grant the petition and full review of the matter.

Respectfully submitted,

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